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## Opening the Courts to Protect Interests Abroad: The Effect of Foreign Sovereign Immunities Act on Litigation with Developing Countries

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# OPENING THE COURTS TO PROTECT INTERESTS ABROAD: THE EFFECT OF THE FOREIGN SOVEREIGN IMMUNITIES ACT ON LITIGATION WITH DEVELOPING COUNTRIES

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## I. INTRODUCTION

Since the end of World War II developing countries have struggled to achieve economic and political autonomy. The developing countries first achieved political autonomy with the demise of the colonial regime.<sup>1</sup> These new countries then began to terminate the exploitative foreign investment regime that had originated during the colonial period.<sup>2</sup> Over time, the developing countries articulated an agenda promoting Third World economic autonomy.<sup>3</sup> This agenda featured a system of trade preferences which shielded de-

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<sup>1</sup> See Declaration on the Establishment of a New International Economic Order, G.A. Res. 3201, 6 U.N. GAOR Special Sess. Supp. (No. 1) at 3, U.N. Doc. A/9559 (1974), at ¶ 1 [hereinafter "NIEO"].

<sup>2</sup> See generally Akinsaya, *Host Governments' Responses to Foreign Economic Control: Experiences of Selected African Countries*, 30 INT'L & COMP. L.Q. 769, 769-70 (1981).

<sup>3</sup> See, e.g., NIEO, *supra* note 1; see generally The Charter of Economic Rights and Duties of States, G.A. Res. 3281, 29 U.N. GAOR Supp. (No. 31) at 50, U.N. Doc. A/9631 (1974) [hereinafter "the Charter"].

veloping countries from international competition<sup>4</sup> and allowed them autonomy in structuring their economies.<sup>5</sup> In order to promote these economic aims while furthering political independence, the agenda also claimed for developing countries the right to expropriate foreign holdings and exclusive jurisdiction of disputes arising from those takings.<sup>6</sup>

Western investors in the Third World have come to fear two aspects of this development agenda. First, the agenda asserted the right of developing countries to nationalize and expropriate foreign investments, threatening Western Third World investments.<sup>7</sup> Second, developing country jurisdiction of investment disputes can reduce the likelihood of a fair trial for Western investors.<sup>8</sup> These fears prompted rejection of the development agenda by Western countries<sup>9</sup> and legislative expansion by Western courts of their jurisdiction over the sovereign acts of developing countries.<sup>10</sup> Under the doctrine of restrictive sovereign immunity, an act of a foreign government is immune to suit only insofar as the act is one reserved to a sovereign entity.<sup>11</sup> Western courts employ this doctrine to examine the commercial activities of developing states and to protect Western interests.

<sup>4</sup> See NIEO, *supra* note 1, at ¶ 4(n) (Industrial nations should accord non-reciprocal preferential treatment for developing countries).

<sup>5</sup> See *id.* at ¶ 4(a) (asserting the sovereign equality of developing states and their right to self-determination).

<sup>6</sup> See the Charter, *supra* note 3, at Article 2, ¶ 2 (developing countries have the right to adjudicate investment disputes under their own laws).

<sup>7</sup> See R. MEAGHER, AN INTERNATIONAL REDISTRIBUTION OF WEALTH AND POWER 51 (1979) (Western nations opposed the right of expropriation asserted in the Charter). In fact, fear of expropriation discouraged direct Third World investment by Western transnational corporations during the 1970s, leading to a decrease in direct Western investment. See Note, *Debt Equity Swaps in Developing Countries: Toward a Workable System*, 9 B.C. THIRD WORLD L.J. 39, 40 (1989) [hereinafter *Debt Equity Swaps*].

<sup>8</sup> See *McDonnell Douglas Corp. v. Islamic Republic of Iran*, 591 F. Supp. 293, 304–05 (E.D. Mo. 1984) (U.S. plaintiff deemed unable to receive a fair trial in an Iranian forum), *aff'd*, 758 F.2d 341 (8th Cir.), *cert. denied*, 474 U.S. 948 (1985).

<sup>9</sup> See Award on the Merits in Dispute Between Texas Overseas Petroleum Company/California Asiatic Oil Company and the Government of the Libyan Arab Republic, 17 INT'L LEGAL MATERIALS 1, 21, 22 (1977) [hereinafter *Topco/Calasiatic Arbitration*] (while countries have the right to expropriate foreign property within their territory, jurisdiction for such takings must be made in accordance with the precepts of customary international law).

<sup>10</sup> See generally Foreign Sovereign Immunities Act, Pub. L. 94–583, 90 Stat. 2891 (1976) (codified at 28 U.S.C. §§ 1330, 1602–1611 (1982)) (United States); The State Immunity Act, 1978, ch. 33 (United Kingdom) (statutory provisions expanding jurisdiction over sovereign acts by adoption of restrictive sovereign immunity).

<sup>11</sup> See HOUSE COMMITTEE ON THE JUDICIARY, FOREIGN SOVEREIGN IMMUNITIES ACT OF 1976, H.R. REP. NO. 1487, 94th Cong., 2d. Sess. 7, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 6604, 6605 [hereinafter *HOUSE REPORT*].

The expansion of Western courts' jurisdiction under restrictive sovereign immunity, especially in the United States, harms developing countries. Expansive interpretation of U.S. jurisdictional law by the federal bench has combined with the attractiveness of U.S. courts to draw lawsuits to the United States. Claimants against developing countries are thus encouraged to file suit in U.S. courts, which are often far from both the evidence of the dispute and the legal domiciles of the litigants.<sup>12</sup> The harm to developing countries, however, is not limited to inconvenience in litigation. Exercise of jurisdiction over sovereign disputes by Western courts constitutes an implicit rejection of the development agenda.

This Note examines the expansion of Western jurisdiction over sovereign acts and the implicit rejection of the development agenda. The development agenda, through the New International Economic Order (NIEO)<sup>13</sup> and the Charter of Economic Rights and Duties of States (the Charter),<sup>14</sup> attempts to foster global economic development through a system of legal rights and economic preferences inuring to the benefit of developing countries. As part of this agenda, developing countries maintain that they may unilaterally act to alter agreements with Western interests and resolve the disputes in their own courts. This stance has reinforced Western resistance to the development agenda.

This Note further examines the doctrine of restrictive sovereign immunity, which, contrary to Third World assertions, allows domestic courts to examine the acts of foreign sovereigns. The doctrine was expanded through litigation over the Nigerian cement crisis, an attempt by Nigeria to abrogate a large number of international concrete supply contracts.<sup>15</sup> The resulting litigation solidified the doctrine of restrictive sovereign immunity in West Germany, Great Britain and the United States. Subsequent United States cases have shown it is likely that developing countries will continue to face litigation in U.S. courts.<sup>16</sup> As the Conclusion sug-

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<sup>12</sup> Ironically, the expansion of U.S. courts' jurisdiction under the FSIA ignores the concerns of fairness which have traditionally informed U.S. jurisdictional law. *See International Shoe Co. v. State of Washington*, 326 U.S. 310, 316 (1945) (jurisdiction should not be granted where maintenance of suit offends "traditional notions of fair play and substantial justice . . .") (*quoting* *Milliken v. Meyer*, 311 U.S. 457, 463 (1940)).

<sup>13</sup> *Supra* note 1.

<sup>14</sup> *Supra* note 3.

<sup>15</sup> *See infra* text accompanying notes 97-106.

<sup>16</sup> *See, e.g.,* *Proyecfin de Venezuela, S.A. v. Banco Industrial de Venezuela, S.A.*, 760 F.2d 390 (2d Cir. 1985) (suit by Venezuelan plaintiff against Venezuelan government bank permitted in U.S. court under the FSIA).

gests, developing countries may best respond by resorting to the relatively more favorable means of international arbitration.

## II. THE REJECTION OF THE DEVELOPMENT AGENDA AS A SOURCE OF LAW

The desire of politically independent nations in the Third World to achieve economic independence was the genesis of the development agenda. As one Indian scholar notes, "having achieved their political independence after a long struggle, the poor . . . countries of the Third World want to attain economic liberation without which their political life is stultified. All over the world the poor have decided that poverty is neither inevitable nor tolerable any longer."<sup>17</sup> The developing countries adopted a program of action to marry economic independence to political independence.

After World War II the developing countries acquired a voting majority in the United Nations (U.N.) and used it as a forum for advocating an economic reform agenda. The agenda called for a system of trade preferences, economic aid and legal rights meant to encourage trade by developing countries. In addition, the agenda advocated the right of developing countries to expropriate foreign holdings in natural resources and to resolve the question of compensation in domestic courts. The developing countries' adherence to a right of expropriation has fostered Western opposition to the development agenda.

### A. *The Economic Background of the Development Agenda*

The inequities that prompted the NIEO and the Charter stem from Western exploitation of Third World natural resources during the nineteenth and early twentieth centuries. Western investors espoused economic liberalism, which "assumed freedom of contract and formal equality before the law, but did not guarantee equality in bargaining power . . . ."<sup>18</sup> Armed with these principles of Western law, investors soon found that "the surest method of dispossessing a native people of their lands and natural resources was to acknowledge their unfettered freedom of alienation."<sup>19</sup> Foreign investors

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<sup>17</sup> R. ANAND, *INTERNATIONAL LAW AND THE DEVELOPING COUNTRIES* 106 (1987).

<sup>18</sup> Boczek, *Ideology and the Law of the Sea: The Challenge of the New International Economic Order*, 7 B.C. INT'L & COMP. L. REV. 1, 5 (1984).

<sup>19</sup> See Asante, *Restructuring Transnational Mineral Agreements*, 73 AM. J. INT'L L. 335, 338 (1979) (citing K. HANCOCK, 2 SURVEY OF BRITISH COMMONWEALTH AFFAIRS 182).

invoked Western law to obtain large mineral extraction concessions from peoples that had no idea of what they had signed away.<sup>20</sup> Typically, these concessions exploited natural resources to the detriment of the host country.<sup>21</sup> Colonies and developing countries generally gave the concessionaires extraordinary privileges in return for meager compensation.<sup>22</sup> The traditional concession regime effected an enormous transfer of wealth which left the developing world severely disadvantaged.

The developing countries eventually freed themselves of the traditional concessions. In their well-known study of developing country mineral agreements,<sup>23</sup> David Smith and Louis Wells of Harvard University identified four factors that helped bring about change in the extraction agreements: (1) the change in the industry structure; (2) the position of various firms in their industry; (3) the economic and political conditions in the host countries; and (4) the bargaining skill of the host countries.<sup>24</sup> Thus, events such as mineral shortages,<sup>25</sup> the multiplication of small Western firms leading to increased competition,<sup>26</sup> and domestic political pressure<sup>27</sup> have enabled developing countries to improve their positions *vis-à-vis* Western industrial concerns.

Nonetheless, inequities persist. The capital intensive nature of much Third World development, especially mining and creation of the industrial infrastructure, forces capital-poor developing coun-

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<sup>20</sup> See R. MEAGHER, *supra* note 7, at 51.

<sup>21</sup> The raw materials extraction regime provides an illustrative example of Third World exploitation. See generally D. SMITH & L. WELLS, JR., *NEGOTIATING THIRD-WORLD MINERAL AGREEMENTS* (1975).

<sup>22</sup> The typical raw materials concession yielded only rent to the host country. All returns from the undertaking went to the Western concessionaire, who also controlled management of the resource, set production levels and had sole responsibility for processing and marketing of the refined commodity. See Asante, *supra* note 19, at 339. A concessionaire typically leased vast tracts of land for long periods of time at a nominal rent. For example, a 1926 agreement between Liberia and Firestone Tire and Rubber Co. granted Firestone a ninety-nine year lease on a 1 million acre rubber plantation at an annual rental of six cents per acre. Firestone only farmed 190,000 acres. Adede, *A Profile of Trends in the State Contracts for Natural Resources Development Between African Countries and Foreign Companies*, 12 INT'L L. & POL. 479, 490-91 (1980).

<sup>23</sup> D. SMITH & L. WELLS, *supra* note 21.

<sup>24</sup> *Id.* at 6-7.

<sup>25</sup> For example, the oil crisis of 1973 drastically improved the bargaining position of the OPEC nations.

<sup>26</sup> The rise of "independent" American oil companies in the 1950s and 1960s led to bidding wars with the major oil companies for a larger share of the world market. See Zakariya, *New Directions in the Search for and Development of Petroleum Resources in the Developing Countries*, 9 VAND. J. OF TRANSNAT'L L. 545, 556 (1976).

<sup>27</sup> D. SMITH & L. WELLS, *supra* note 21, at 18-19.

tries to rely on foreign investors.<sup>28</sup> Moreover, fluctuations in raw materials prices on international markets cause fluctuations in the bargaining power of the developing countries.<sup>29</sup> As a consequence, developing countries perceive a need to progress beyond the gains achieved in the post-World War II period to an order premised on equity, autonomy and stability.

### B. *The Development Agenda and Its Features*

The developing countries first articulated the development agenda in 1973 through the adoption of the NIEO by the U.N. General Assembly.<sup>30</sup> The NIEO declaration followed a decade of unsuccessful attempts to find a moderate means of furthering developing country aims.<sup>31</sup> The NIEO instead took a bold stance, asserting that "the remaining vestiges of alien and colonial domination . . . continue to be among the greatest obstacles to the full emancipation and progress of the developing countries and all the peoples involved."<sup>32</sup> To redress these inequities, the NIEO advocated "full permanent sovereignty of every State over its natural resources and all economic activities,"<sup>33</sup> "regulation and supervision of the activities of transnational corporations . . ."<sup>34</sup> regulation of international commodities markets,<sup>35</sup> "securing favorable conditions for the transfer of financial resources to developing countries,"<sup>36</sup> "preferential and non-reciprocal treatment for developing countries wherever feasible . . ."<sup>37</sup> and ". . . access to the achievements of modern science and technology."<sup>38</sup>

Beyond its claims for economic preferences, the NIEO contained legal claims which troubled Western nations. In particular,

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<sup>28</sup> *Id.* at 9.

<sup>29</sup> *Accord id.* at 10.

<sup>30</sup> *Supra* note 1.

<sup>31</sup> Such an approach was attempted during the 1960s by the United Nations Conference on Trade and Development (UNCTAD), which proposed a generalized system of preferences (GSP) granting developing countries lower tariffs on exports to industrial states. The GSP failed because developing countries felt it did not adequately address inequities in international trade and the Western countries failed to uniformly implement the scheme. *See R. MEAGHER, supra* note 7, at 29-34.

<sup>32</sup> NIEO, *supra* note 1, at ¶ 1.

<sup>33</sup> *Id.* at ¶ 4(e).

<sup>34</sup> *Id.* at ¶ 4(g).

<sup>35</sup> *Id.* at ¶ 4(j).

<sup>36</sup> *Id.* at ¶ 4(o).

<sup>37</sup> *Id.* at ¶ 4(n).

<sup>38</sup> *Id.* at ¶ 4(p).

paragraph 4(e) of the NIEO provided that each state has "the right to nationalization or transfer of ownership to its nationals [of foreign holdings], this right being an expression of the full permanent sovereignty of the State."<sup>39</sup> While the Western countries believed this provision disadvantaged their investments in developing countries, the NIEO justified the inequity by asserting that "preferential and non-reciprocal treatment" should be accorded to developing countries in order to overcome the disadvantages suffered under the traditional order.<sup>40</sup> The division on this point, however, continued to grow.

In 1974 the U.N. General Assembly approved the Charter of Economic Rights and Duties of States (the Charter).<sup>41</sup> The Charter purported to "promote the establishment of the new international economic order,"<sup>42</sup> providing for sovereignty over natural resources,<sup>43</sup> access of all countries to international trade,<sup>44</sup> transfer of technology from industrial states to developing countries,<sup>45</sup> and favored treatment of developing countries.<sup>46</sup> The most controversial Charter proposition was contained in Article Two:

Each State has the right . . . [t]o nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid . . . taking into account [the] relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals . . . .<sup>47</sup>

In effect, the developing countries claimed the right to seize any foreign-owned property, compensating any dispossessed parties as the state deems fit. Advocates of Article Two argued that developing country expropriation of private property is justified by the emerging concept of modern sovereignty.<sup>48</sup>

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<sup>39</sup> *Id.* at ¶ 4(e).

<sup>40</sup> *Id.* at ¶ 4(n).

<sup>41</sup> *Supra* note 3.

<sup>42</sup> The Charter, *supra* note 3, at Preamble.

<sup>43</sup> *Id.* at art. 2, ¶ 1.

<sup>44</sup> *Id.* at art. 4.

<sup>45</sup> *Id.* at arts. 9, 13.

<sup>46</sup> *Id.* at art. 22, ¶ 1.

<sup>47</sup> *Id.* at art. 2, ¶ 2(c).

<sup>48</sup> See R. MEAGHER, *supra* note 7, at 54.



The expropriation provision of the Charter led industrial nations to withhold approval of the resolution.<sup>49</sup> As Professor Robert Meagher noted, "consensus on [this point] would have made possible consensus on the charter."<sup>50</sup> No consensus, however, was forthcoming. Western countries felt threatened by the use of Third World voting power in the General Assembly to sanction expropriation of foreign direct investment. The U.S. ambassador to the U.N., Daniel Moynihan, scolded the General Assembly for approving the Charter, stating that "resolutions that condemn, that accuse, that anathematize, do not bring us nearer to agreement. They have the opposite effect."<sup>51</sup>

It is unlikely that any of the Charter's provisions will be accepted into international law. The Charter has no legal effect, since U.N. resolutions are not among the sources of law recognized under the statute of the International Court of Justice.<sup>52</sup> Some suggest that the Charter and NIEO have the effect of "creating new norms in the name of progressive development of international law,"<sup>53</sup> which are proposals "*de lege ferenda*."<sup>54</sup> Such standing, however, does not mandate application of the Charter in any tribunal. At best, the Charter and the NIEO can be considered as the articulation of developing country concerns.<sup>55</sup>

The provisions of the Charter are seldom litigated because of their dubious legal footing. In 1977, however, an arbitrator in a dispute between Libya and two U.S. oil companies, Topco and Calasiatic<sup>56</sup> (the Topco/Calasiatic Arbitration), rejected Libya's claim that the principles of the Charter denied him jurisdiction over the dispute.<sup>57</sup> In 1973, Libya issued a decree purporting to nationalize Topco's and Calasiatic's Libyan holdings.<sup>58</sup> The companies submitted the question of compensation to an international arbitrator.

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<sup>49</sup> The U.S., United Kingdom, Federal Republic of Germany, Belgium, Denmark and Luxembourg each voted against the Charter. Austria, Canada, France, Ireland, Italy, Japan, Netherlands, Norway, and Spain abstained. *Id.* at 44.

<sup>50</sup> *Id.* at 51.

<sup>51</sup> R. ANAND, *supra* note 17, at 119.

<sup>52</sup> STATUTE OF THE I.C.J., art. 38 (1945); see also Park, Book Review, 61 B.U.L. REV. 1321, 1322 n.4 (1981).

<sup>53</sup> Adede, *International Law From a Common Law Perspective: A Second Look*, 60 B.U.L. REV. 46, 47-48 (1980).

<sup>54</sup> "About the law which is to be developed." *Id.* at 48 n.8.

<sup>55</sup> See R. ANAND, *supra* note 17, at 115.

<sup>56</sup> Topco (Texas Overseas Petroleum Corporation) is Texaco's international division, while Calasiatic (California Asiatic Oil Company) is Standard Oil of California's international arm.

<sup>57</sup> Topco/Calasiatic Arbitration, 17 INT'L LEGAL MATERIALS at 31.

<sup>58</sup> *Id.* at 1.

Libya, in accordance with the Charter, contended that nationalization "terminated not only the agreement which linked them to the Libyan State but also their [sic] legal status."<sup>59</sup> The French arbitrator, conceding one assertion of the development agenda, stated that "the right of a state to nationalize is unquestionable today."<sup>60</sup> He went on to determine, however, that a country making a contract with a foreign entity avails itself of the rights and protections of international law and thus makes its action of nationalization subject to that law.<sup>61</sup> He concluded that "a State cannot invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty" and rejected Libya's challenge to the contract's validity.<sup>62</sup> It thus seems likely that international law does not countenance the attempts of developing countries to shield sovereign acts from scrutiny under color of the Charter.

Consequently, developing countries continue to face investment disputes in the courts of industrial nations, where claims under the Charter will be similarly denied. Although a developing state sued in a foreign court might simply refuse to appear, this stratagem would be foolhardy. For example, a claimant suing in a U.S. court could obtain a default judgment<sup>63</sup> which could be levied against the property of the defendant sovereign in the U.S.<sup>64</sup> This is also true where a default arbitration award is rendered pursuant to the Convention on Enforcement of Arbitral Awards,<sup>65</sup> to which the United States is a signatory. In short, the attempts of developing states to assert jurisdiction over takings and investment claims is hindered both by the refusal of industrial states to cooperate and by the ability of aggrieved parties to gain access to foreign courts, particularly those of the United States.

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<sup>59</sup> *Id.* at 21.

<sup>60</sup> *Id.*

<sup>61</sup> *See id.* at 31.

<sup>62</sup> *Id.* at 24.

<sup>63</sup> FED. R. CIV. P. 55(a).

<sup>64</sup> 28 U.S.C. § 1610 (1982) provides for attachment of property of a foreign sovereign where 1) the sovereign waives immunity from attachment (§ 1610(a)(1)) *see* note 65 *infra*; 2) where the property attached is the object of the suit (§ 1610(a)(2), (a)(4)); or 3) where the suit arises out of a taking in violation of international law (§ 1610(a)(3)). Military and central bank funds are generally exempt from attachment. 28 U.S.C. § 1611(b).

<sup>65</sup> 9 U.S.C. § 201 (1982). Any foreign sovereign who consents to arbitration of investment disputes waives immunity to enforcement of arbitral awards in any country which is a signatory to the agreement. *See* *Ipitrade International v. Federal Republic of Nigeria*, 465 F. Supp. 824, 826-27 (D.D.C. 1978) (Nigeria's consent to arbitration waived immunity to enforcement of the arbitral award and also to attachment of funds in the U.S. 28 U.S.C. § 1610(a)(1)). The presence of many international bank accounts in the U.S. makes it an ideal situs for enforcement of arbitral awards under the above mentioned provisions.

### III. THE DEMISE OF ABSOLUTE SOVEREIGN IMMUNITY AND THE EXPANSION OF UNITED STATES JURISDICTION OVER FOREIGN SOVEREIGNS

The likelihood of increased litigation in Western courts has grown in recent years. Western courts have expanded their jurisdiction over state acts under the doctrine of restrictive sovereign immunity. Previously, developing countries could shield their state-run enterprises behind the doctrine of absolute sovereign immunity, which forbade courts to exercise authority over foreign sovereigns.<sup>66</sup> Since World War II, however, international law has increasingly accepted the right of courts to adjudicate disputes arising from the commercial acts of foreign sovereigns.<sup>67</sup> This exception was expanded by the Nigerian cement crisis,<sup>68</sup> in which Nigeria attempted to repudiate a large number of international contracts. In order to deal with lawsuits arising from the crisis, courts in West Germany, the United Kingdom and the United States expanded jurisdiction under the doctrine of restrictive sovereign immunity.<sup>69</sup> As a result, the claims of juridical autonomy under the Charter and NIEO have been further nullified, increasing the likelihood that Third World states will face litigation in Western courts.

#### A. *Foreign Sovereign Immunity Before the Nigerian Cement Crisis*

International law traditionally held sovereign entities immune from suit in foreign courts under all circumstances.<sup>70</sup> This principle, absolute sovereign immunity, arose out of the presumed equality of nations.<sup>71</sup> In the interest of international comity, states restricted their jurisdiction by not reaching across their borders to hale foreign sovereigns into domestic courts.<sup>72</sup>

The principle of absolute sovereign immunity was first applied in the U.S. in 1812. In *The Schooner Exchange v. M'Faddon*,<sup>73</sup> the Supreme Court refused to exercise jurisdiction over a suit by a U.S. citizen against France. M'Faddon hoped to recover one of his ships

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<sup>66</sup> See, e.g., 18 HALSBURY'S LAWS ¶ 1548 (4th ed. 1985) (United Kingdom) (absolute sovereign immunity traditionally prevailed in England).

<sup>67</sup> See HOUSE REPORT, *supra* note 11, at 6607.

<sup>68</sup> See *infra* text accompanying notes 97-106.

<sup>69</sup> See *infra* cases collected at note 106.

<sup>70</sup> See 18 HALSBURY'S LAWS at ¶ 1548.

<sup>71</sup> *The Schooner Exchange v. M'Faddon*, 11 U.S. (7 Cranch) 116, 137 (1812).

<sup>72</sup> *Id.* at 137.

<sup>73</sup> 11 U.S. (7 Cranch) 116.

which had been captured and impressed into Napoleon's navy.<sup>74</sup> The Court determined that the French emperor was beyond its reach. Justice Marshall wrote that the "perfect equality and absolute independence of sovereigns, and this common interest impelling them to mutual intercourse . . . have given rise to a class of cases in which every sovereign is understood to waive the exercise . . . of [its] complete exclusive territorial jurisdiction [with respect to the acts of other sovereigns] . . . ." <sup>75</sup> The U.S. courts thus refused to examine the acts of foreign sovereigns.<sup>76</sup>

Over a century later the U.S. retreated from *The Schooner Exchange* with the publication of the "Tate letter" in 1952.<sup>77</sup> In that letter, the State Department declared that U.S. foreign policy only required jurisdictional immunity for foreign sovereigns with respect to their non-commercial acts and allowed exercise of jurisdiction over suits against foreign sovereigns arising in a commercial context.<sup>78</sup> This policy followed two contemporary Supreme Court rulings suggesting that absolute sovereign immunity was merely a means of protecting foreign relations.<sup>79</sup> The new policy recognized the dominant trend in international law allowing domestic jurisdiction over the commercial acts of sovereigns.<sup>80</sup>

While the Tate letter nominally expanded jurisdiction over sovereign acts, it did not in fact facilitate suit against foreign sovereigns. Determinations of whether immunity applied were made by the State Department.<sup>81</sup> Amenability of a foreign sovereign to a suit in the U.S. was supposed to be based on whether the suit arose in a commercial context. In fact, "determinations of judicial jurisdiction . . . were made subject to the exigencies of United States foreign policy," leading the State Department "to play a larger role in determinations of immunity."<sup>82</sup>

In order to remedy the uncertainties of the Tate letter regime, Congress passed the Foreign Sovereign Immunities Act of 1976

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<sup>74</sup> *Id.* at 117.

<sup>75</sup> *Id.* at 137.

<sup>76</sup> *Id.* at 147.

<sup>77</sup> Changed Policy Concerning the Granting of Sovereign Immunity to Foreign Governments, 26 Dep't of State Bull. 984 (1952) [hereinafter "Tate letter"].

<sup>78</sup> *Id.* at 984-85; see also HOUSE REPORT, *supra* note 11, at 6607.

<sup>79</sup> See *Ex Parte Peru*, 318 U.S. 578 (1943); *Mexico v. Hoffman*, 324 U.S. 30 (1945).

<sup>80</sup> Tate letter, *supra* note 77, at 984.

<sup>81</sup> See Note, *Effects Jurisdiction Under the Foreign Sovereign Immunities Act and the Due Process Clause*, 55 N.Y.U. L. REV. 474, 478 n.32 (1980) (citation omitted).

<sup>82</sup> *Id.* at 478.

(FSIA).<sup>83</sup> By codifying restrictive sovereign immunity as positive law, Congress allowed the courts to expand their jurisdiction over sovereign acts. This is clear from the three purposes asserted in the legislative history:

- 1) To codify the restrictive theory of sovereign immunity.<sup>84</sup> As codified, foreign sovereigns are liable to suit arising from any action which might also be taken by a lay person.<sup>85</sup>
- 2) To remove determination of jurisdiction from the Executive to the Judiciary.<sup>86</sup> Application of immunity thus becomes an item of judicial discretion.<sup>87</sup>
- 3) To provide statutory procedure for service on a foreign sovereign.<sup>88</sup>

In sum, the provisions of the FSIA are "intended to encourage the bringing of actions against foreign states in Federal courts."<sup>89</sup> Moreover, the statute is the sole jurisdictional basis of any suit against a foreign sovereign in the U.S. courts.<sup>90</sup>

The FSIA has two major provisions. First, it grants federal courts subject matter jurisdiction and personal jurisdiction against a foreign sovereign not entitled to immunity as prescribed by the act.<sup>91</sup> It then specifies that a foreign sovereign is immune to suit in federal court with certain qualified exceptions.<sup>92</sup> These exceptions include waiver of immunity by the sovereign,<sup>93</sup> suit based on commercial activity of the foreign sovereign, the "commercial acts exception" to sovereign immunity,<sup>94</sup> and taking of property by a foreign sovereign in violation of international law.<sup>95</sup> As may be imagined, these exceptions have largely swallowed up the purported rule granting sovereign immunity. In accord with Congressional intent, the statute expands U.S. jurisdiction over the acts of foreign

<sup>83</sup> Pub. L. 94-583, 90 Stat. 2891 (codified at 28 U.S.C. §§ 1330, 1602-1611).

<sup>84</sup> HOUSE REPORT, *supra* note 11, at 6605.

<sup>85</sup> *See id.*

<sup>86</sup> *Id.* at 6605-06.

<sup>87</sup> *See id.* at 6613; *see also* 28 U.S.C. § 1602.

<sup>88</sup> HOUSE REPORT, *supra* note 11, at 6606.

<sup>89</sup> *Id.* at 6612.

<sup>90</sup> *See Argentine Republic v. Amerada Hess Shipping Corp.*, 109 S. Ct. 683, 688 (1989) (FSIA provides sole basis for federal court jurisdiction over foreign sovereigns).

<sup>91</sup> 28 U.S.C. § 1330(a), (b).

<sup>92</sup> *See* 28 U.S.C. § 1604.

<sup>93</sup> 28 U.S.C. § 1605(a)(1).

<sup>94</sup> 28 U.S.C. § 1605(a)(2).

<sup>95</sup> 28 U.S.C. § 1605(a)(3). This provision explicitly gives federal courts jurisdiction over takings of private property, thus nullifying the claim of exclusive jurisdiction articulated in the Charter. *See* note 47 *supra*, and accompanying text.

sovereigns. Under the commercial acts exception to sovereign immunity, no dispute arising from a contract with a foreign sovereign is immune from suit in the U.S. if a sufficient nexus to the U.S. can be shown.

B. *The Nigerian Cement Crisis and Expansion of Western Jurisdiction Over Sovereign Acts*

In 1975 Nigeria placed orders worldwide for a greater quantity of cement than it could possibly unload or use. The resulting confusion has been aptly dubbed the Nigerian cement crisis. The crisis precipitated the fall of the civilian government and ended with a large number of lawsuits by unsatisfied Western creditors seeking payment from the Central Bank of Nigeria (CBN) for cement which had been delivered to Nigeria. In order to accommodate these suits, courts in Great Britain, the United States and the Federal Republic of Germany expanded their jurisdiction over sovereign acts under the doctrine of restrictive sovereign immunity.<sup>96</sup> The crisis thus served as a vehicle for expanding Western courts' jurisdiction over sovereign acts.

The events of the crisis transpired roughly as follows.<sup>97</sup> Rich with oil revenues in the wake of the first oil crisis, Nigeria let a large number<sup>98</sup> of contracts for procurement of cement, expecting a response rate of about ten percent.<sup>99</sup> The contracts, however, provided for demurrage on a per diem basis,<sup>100</sup> making the deal very

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<sup>96</sup> See, e.g., *Trendtex Trading Corp. v. Central Bank of Nigeria*, [1977] 1 All E.R. 881, 883 (C.A.) (a case arising from the Nigerian cement crisis prompts the Court of Appeals of the United Kingdom to adopt restrictive sovereign immunity); *Verlinden, B.V. v. Central Bank of Nigeria*, 488 F. Supp. 1284 (S.D.N.Y. 1980), *aff'd on other grounds*, 647 F.2d 320 (2d Cir. 1981), *rev'd and remanded*, 461 U.S. 480, 497 (1983) (U.S. Supreme Court upholds exercise of subject matter jurisdiction over dispute arising from the cement crisis); *Texas Trading Corp. v. Federal Republic of Nigeria*, 647 F.2d 300, 315 (2d Cir.) (United States appeals court upholds exercise of personal jurisdiction in cement crisis dispute under FSIA), *cert. denied*, 454 U.S. 1148 (1981); *Nonresident Petitioner v. Central Bank of Nigeria*, 16 INT'L LEGAL MATERIALS 501, 503 (1977) (court in the Federal Republic of Germany adopts restrictive sovereign immunity in case arising from cement crisis). See *infra* note 106 and accompanying text.

<sup>97</sup> The facts as related below are generally taken from *National American Corp. v. Federal Republic of Nigeria*, 448 F. Supp. 622 (S.D.N.Y. 1978), *aff'd*, 597 F.2d 314 (2d Cir. 1979), which is the best synopsis of the relevant events. These facts, with minor variations, apply to all of the Nigerian cement cases discussed.

<sup>98</sup> Accounts of the number of contracts vary from 68, *id.* at 626, to 109, *Verlinden, B.V.*, 461 U.S. at 483 n.2.

<sup>99</sup> *National American Corp.*, 448 F. Supp. at 626.

<sup>100</sup> Demurrage is a payment made by a consignee to a consignor when the consignor's vessel is delayed in unloading its cargo. *Id.* at 627 n.1. Per diem demurrage accrues at a

attractive to international traders. Nigeria's harbors were soon clogged with ships carrying an aggregate total of sixteen million tons of cement, paralyzing the harbors and seriously endangering the flow of other vital goods.<sup>101</sup>

With commerce immobilized and demurrage rapidly mounting, a new military government assumed control,<sup>102</sup> and suspended demurrage payments.<sup>103</sup> Although the cement supply contracts nominally authorized unlimited demurrage payments to the sellers whose ships awaited unloading, demurrage payments under the letters of credit issued to the sellers were actually conditional on authorization from the government of Nigeria, which authorization was withdrawn.<sup>104</sup> The sellers who subsequently presented valid demurrage claims to the correspondent banks found no largesse forthcoming.<sup>105</sup> Nigeria's repudiation of its demurrage obligations spawned lawsuits in several countries, alleging anticipatory breach of the contracts.<sup>106</sup> In every case the doctrine of restrictive sovereign immunity allowed jurisdiction of the disputes.<sup>107</sup>

The cement crisis cases arising in the U.S. are particularly illustrative of expansion of Western courts' jurisdiction under the doctrine of restrictive sovereign immunity. CBN was unable to invoke absolute sovereign immunity as a defense to the cement crisis

standard daily rate for each ship, regardless of the amount of goods it carries. The agreement by Nigeria to pay demurrage on a per diem basis created an incentive for shippers to deliver their consignments in as many small-capacity ships as possible. *Id.* at 627.

<sup>101</sup> *Texas Trading Corp.*, 647 F.2d at 305. Estimates of Nigeria's normal annual off-loading capacity ranged between one and five million metric tons. *Id.*

<sup>102</sup> *Trendtex Trading Corp.*, [1977] 1 All E.R. at 883.

<sup>103</sup> *National American Corp.*, 448 F. Supp. at 629.

<sup>104</sup> In a typical letter of credit transaction, the buyer (here Nigeria) has its bank (CBN) establish a line of credit with a correspondent bank in the country of the seller. When the seller then delivers the goods to the buyer, the seller can receive payment from the correspondent bank by presenting the letter of credit and documentation demonstrating performance of its obligations. See generally U.C.C. art. 5; see also Auerbach, *Letters of Credit — A Concise Codification*, 23 OHIO ST. L.J. 246, 246-47 (1962). While the cement supply contracts had called for Nigeria to issue irrevocable letters of credit, see *National American Corp.*, 448 F. Supp. at 627, CBN in fact issued conditional letters of credit to the sellers on which the correspondent banks were not independently liable. When CBN withheld authorization for payment under the letters of credit, the correspondent banks were not required to continue to pay demurrage. See *Texas Trading Corp.*, 647 F.2d at 304.

<sup>105</sup> See *National American Corp.*, 448 F. Supp. at 629.

<sup>106</sup> See, e.g., *Trendtex Trading Corp.*, [1977] 1 All E.R. 881 (United Kingdom); *Verlinden, B.V.*, 461 U.S. 480; *Texas Trading Corp.*, 647 F.2d 300 (United States); *Nonresident Petitioner*, 16 INT'L LEGAL MATERIALS 501 (Federal Republic of Germany).

<sup>107</sup> *Trendtex Trading Corp.*, [1977] 1 All E.R. at 895; *Verlinden, B.V.*, 461 U.S. at 497; *Texas Trading Corp.*, 647 F.2d at 315; *Nonresident Petitioner*, 16 INT'L LEGAL MATERIALS at 503.

suits it faced in U.S. courts. It did, however, hope to show that even restrictive sovereign immunity, as codified by the FSIA, permitted neither subject matter jurisdiction nor personal jurisdiction<sup>108</sup> over suits arising from the crisis. In fact, the subsequent decisions determined that the litigation spawned by the crisis was within the FSIA grant of jurisdiction.<sup>109</sup> The Supreme Court held in *Verlinden, B.V. v. Central Bank of Nigeria*<sup>110</sup> that federal courts always have subject matter jurisdiction over permissible suits against foreign sovereigns, since the courts are required to construe the FSIA and because the suits arise under federal law.<sup>111</sup> In *Texas Trading Co. v. Federal Republic of Nigeria*,<sup>112</sup> the Second Circuit held that a commercial transaction with a foreign sovereign need have only minimal contacts to the U.S. in order for U.S. courts to obtain personal jurisdiction over the sovereign.<sup>113</sup> Taken together, the holdings in *Verlinden* and *Texas Trading* expand personal jurisdiction and subject matter jurisdiction over suits against foreign sovereigns, increasing the probability of U.S. litigation of developing countries' investment disputes.

The most significant of the U.S. cases arising from the Nigerian cement crisis was *Verlinden*. At trial the case was dismissed for lack of personal jurisdiction over the defendant.<sup>114</sup> Turning to the legislative history of the FSIA, Judge Weinfeld of the Southern District of New York determined that the court could exercise jurisdiction of a foreign dispute only where "a 'substantial' effect within the territory 'occurs as a direct and foreseeable result of conduct outside the territory.'"<sup>115</sup> Payment by CBN's U.S. correspondent bank was held not to create a substantial effect in the U.S., making the contacts between the dispute and the U.S. insufficient to support ex-

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<sup>108</sup> See *Verlinden, B.V.*, 647 F.2d at 324 (raising the issue of subject matter jurisdiction under the FSIA); *Texas Trading Corp.*, 647 F.2d at 306 (raising the issue of personal jurisdiction under the FSIA).

<sup>109</sup> See *Verlinden, B.V.*, 461 U.S. at 497 (subject matter jurisdiction granted); *Texas Trading Corp.*, 647 F.2d at 315 (personal jurisdiction granted).

<sup>110</sup> 488 F. Supp. 1284, *aff'd on other grounds*, 647 F.2d 320, *rev'd and remanded*, 461 U.S. 480.

<sup>111</sup> *Verlinden, B.V.*, 461 U.S. at 497.

<sup>112</sup> 647 F.2d 300.

<sup>113</sup> See *Texas Trading Corp.*, 647 F.2d at 314 (Nigeria's close relationship to Morgan Guaranty Bank was a purposeful contact with the U.S. which made it permissible to exercise personal jurisdiction over the suit).

<sup>114</sup> 488 F. Supp. at 1302. The court implies in its holding that grounds for exercise of personal jurisdiction might exist where Nigeria had waived immunity to suit. *Id.*

<sup>115</sup> *Id.* at 1298, *quoting* Harris v. VAO Intourist, Moscow, 481 F. Supp. 1056, 1062-63 (E.D.N.Y. 1979).



ercise of personal jurisdiction under the FSIA direct commercial effect exception.<sup>116</sup>

A three judge panel of the Second Circuit affirmed Judge Weinfeld on different grounds.<sup>117</sup> The court raised *sua sponte* the issue of whether applying the FSIA to the facts in *Verlinden* violated the U.S. Constitution's grant of federal court subject matter jurisdiction.<sup>118</sup> The court found that article III of the Constitution permits jurisdiction over suits by aliens under the FSIA only where the controversy "arises under" the laws of the United States.<sup>119</sup> In *Verlinden*, however, the contract between Verlinden and Nigeria was not made in the U.S., nor was it made pursuant to U.S. law. Both litigants were aliens. The only issue of U.S. law raised in the suit was construction of the FSIA. The panel held that interpretation of a jurisdictional statute such as the FSIA does not raise a question of substantive law sufficient to satisfy the constitutional requirement for exercise of subject matter jurisdiction. The FSIA merely dictated whether the case could be heard and not whether the plaintiff or defendant would prevail on the merits.<sup>120</sup> Since the case did not arise under substantive U.S. law, the Second Circuit found it unconstitutional to entertain Verlinden's suit in the U.S.<sup>121</sup>

The Supreme Court, however, considered the constitutional issue raised by the Second Circuit in *Verlinden* and found that U.S. courts could constitutionally exercise jurisdiction over the suit.<sup>122</sup> In an opinion by Chief Justice Burger, the Court first noted that Congress could confer federal court jurisdiction of any case calling for the "application of Federal law."<sup>123</sup> The Court found that federal courts are required to apply the FSIA whenever a foreign sovereign is sued in U.S. courts.<sup>124</sup> Thus, such suits "arise under" federal law and fall within the constitutional grant of subject matter jurisdic-

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<sup>116</sup> 488 F. Supp. at 1297-1300.

<sup>117</sup> See 647 F.2d 320.

<sup>118</sup> U.S. CONST., art. III, § 2, cl. 1, provides that "the judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution [and] the Law of the United States . . . ." (emphasis added).

<sup>119</sup> Since the article III grant of diversity jurisdiction does not explicitly contemplate suit between an alien plaintiff and an alien defendant, such suits must raise a substantive issue of U.S. law in order to meet the constitutional requirement that the suit "arise under" the laws of the U.S. 647 F.2d at 325.

<sup>120</sup> See *id.* at 327. Furthermore, a holding that jurisdictional statutes confer "arising under" jurisdiction would render the diversity grant in article III surplusage. See *id.* at 329.

<sup>121</sup> See *id.* at 330.

<sup>122</sup> 461 U.S. 480.

<sup>123</sup> *Id.* at 492.

<sup>124</sup> *Id.* at 493.

tion.<sup>125</sup> The Court reversed the ruling of the Second Circuit and remanded the case for further proceedings.<sup>126</sup>

The holding in *Verlinden* is a tautology. In effect, the Court holds that U.S. courts have subject matter jurisdiction over suits brought pursuant to the FSIA because the trial court is required to determine the existence of subject matter jurisdiction under the FSIA. In other words, no grounds exist under the FSIA to dismiss a suit against a foreign sovereign for lack of subject matter jurisdiction. The import of this holding is that it allows suits in U.S. courts where no issue of substantive U.S. law is raised. Application of the FSIA is enough to allow exercise of subject matter jurisdiction by the U.S. courts.

One possible underpinning of the *Verlinden* decision may have been a desire to protect U.S. foreign investment. *Verlinden* pointed out in its brief that "85 percent of U.S. foreign direct investment is made through foreign subsidiaries [which in 1977] had over \$507 billion in sales and \$355 billion in assets."<sup>127</sup> The Supreme Court likely thought it prudent to allow such entities access to U.S. courts, where they would enjoy both a friendly forum and freedom from application of foreign procedure.<sup>128</sup>

Although *Verlinden* effectively allowed exercise of subject matter jurisdiction of all suits brought under the FSIA, it did not discuss the standards for exercise of personal jurisdiction. In suits against foreign sovereigns, personal jurisdiction hinges on the contacts between the dispute and the U.S.<sup>129</sup> In *Texas Trading*,<sup>130</sup> another piece of the cement crisis litigation filed in the U.S., the Second Circuit expanded the reach of U.S. courts by broadly construing the grant of personal jurisdiction under the FSIA commercial acts exception. The plaintiff, Texas Trading Co., had sued CBN for ordering its

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<sup>125</sup> *Id.* at 497.

<sup>126</sup> Having resolved the issue of subject matter jurisdiction, the Court remanded the case for determination of whether an exception applied which would give U.S. courts personal jurisdiction over the suit. 461 U.S. at 499. No ruling has subsequently been issued in the case.

<sup>127</sup> Brief for Petitioner at 13, *Verlinden, B.V. v. Central Bank of Nigeria*, 461 U.S. 480 (1983), quoted in Note, *The Supreme Court's Verlinden Decision: A Retreat to Activism*, 16 VAND. J. OF TRANSNAT'L L. 1081, 1120 n.245 (1983). These figures include only majority-owned, non-bank foreign affiliates and thus represent only part of the exposure of U.S. investment held in the name of foreign entities. *Id.*

<sup>128</sup> Suit in the U.S. spares plaintiffs application of the Charter and NIEO, although it is highly improbable the Court considered that point.

<sup>129</sup> See *Texas Trading Corp.*, 647 F.2d 300.

<sup>130</sup> *Id.*

American correspondent bank, Morgan Guaranty, to withhold payment for cement delivered by Texas Trading.<sup>131</sup> The Second Circuit permitted exercise of jurisdiction over the suit, basing its ruling on the commercial acts exception to sovereign immunity.<sup>132</sup> The court reasoned that Nigeria, having contracted to buy cement, had engaged in a transaction not limited to sovereign entities and was not entitled to immunity.<sup>133</sup> Moreover, the Second Circuit considered the commercial act to have "direct effect"<sup>134</sup> on the United States because payment was made through Morgan Guaranty, a U.S. bank, to a U.S. corporate entity.<sup>135</sup> While the Second Circuit acknowledged that this nexus might be somewhat attenuated, it cited "Congress' concern with providing 'access to the courts' to those aggrieved by the commercial acts of a foreign sovereign" as the rationale for broadly construing the FSIA's jurisdictional grant.<sup>136</sup>

The reasoning of *Texas Trading* thus permits suits by U.S. citizens against foreign sovereigns to be brought in federal court where performance of the contract giving rise to the dispute is entirely outside the U.S. In such cases, payment by a U.S. bank on the contract creates a sufficient nexus to the U.S. for exercise of personal jurisdiction under the FSIA.<sup>137</sup> The unanswered question is whether this nexus would have permitted exercise of personal jurisdiction by U.S. courts in cases such as *Verlinden* where the plaintiff is not a U.S. citizen.<sup>138</sup> What is clear, however, is that the rule in *Texas Trading* makes it easier for a potential plaintiff to show a direct commercial effect in the U.S., since a large number of international payments are made through U.S. banks. As *Verlinden* foreclosed objections to exercise of subject matter jurisdiction of suits against foreign sovereigns,<sup>139</sup> litigants can easily sue foreign sovereigns in the U.S. by taking advantage of U.S. courts' broad construction of the direct commercial effects clause of the FSIA.

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<sup>131</sup> *Id.* at 306.

<sup>132</sup> *Id.* at 310.

<sup>133</sup> *See id.* at 309-10.

<sup>134</sup> *Id.* at 314-15.

<sup>135</sup> *Id.* at 314.

<sup>136</sup> *Id.* at 312, (quoting HOUSE REPORT, *supra* note 11, at 6605).

<sup>137</sup> *See Texas Trading Corp.*, 647 F.2d at 314-15.

<sup>138</sup> Although differing from *Verlinden, B.V.* with respect to the citizenship of its plaintiff, *Texas Trading Corp.* also involved delivery of goods outside the U.S. *See id.* at 312. Moreover, a West German court has determined that restrictive sovereign immunity allows alien plaintiffs to hale foreign sovereigns into its courts. *See Nonresident Petitioner*, 16 INT'L LEGAL MATERIALS at 503.

<sup>139</sup> *See Verlinden, B.V.*, 461 U.S. at 497.

#### IV. SUBSEQUENT APPLICATION OF EXPANDED U.S. JURISDICTION OVER SOVEREIGN ACTS

In cases decided after *Verlinden* foreign sovereigns have found it increasingly difficult to resist suit in the U.S. Where a plaintiff puts forward evidence that a sovereign is not entitled to immunity, the sovereign has the burden of showing by a preponderance of the evidence that it is entitled to immunity.<sup>140</sup> In recent opinions construing the FSIA two factors have increased that burden. First, courts persist in employing the expansive construction of the direct commercial effects exception articulated in *Texas Trading*.<sup>141</sup> Second, grants of jurisdiction invoking the commercial effects exception are often based on outside policy considerations. This is especially the case where the suit is against a nation with whom the U.S. has unfriendly relations.<sup>142</sup> Some U.S. courts have exercised restraint in permitting FSIA jurisdiction,<sup>143</sup> suggesting that the door to U.S. courts will not be wide open. Suits brought pursuant to the FSIA have been dismissed on other grounds, such as the Act of State doctrine,<sup>144</sup> or on policy grounds.<sup>145</sup> These cases, however, suggest that disputes with developing countries will only be dismissed from U.S. courts on the merits and not on the basis of the FSIA.

##### A. Broad Construction of the Direct Commercial Effects Exception

The legislative history of the FSIA supports the broad construction of the direct commercial effects exception in *Texas Trading*. The House Report on the FSIA states that, regardless of whether a sovereign act is taken for a public purpose, "it is the essentially commercial nature of an activity or transaction that is critical" to bringing it under the commercial acts exception.<sup>146</sup> Where, for ex-

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<sup>140</sup> *Meadows v. Dominican Republic*, 817 F.2d 517, 523 (9th Cir.), *cert. denied*, 108 S. Ct. 486 (1987).

<sup>141</sup> 647 F.2d at 314-15.

<sup>142</sup> *See, e.g., McDonnell Douglas*, 591 F. Supp. at 304-05.

<sup>143</sup> *See, e.g., Vencedora Oceanica Navigacion v. Compagnie Nationale Algerienne de Navigation*, 730 F.2d 195, 203-204 (5th Cir.) (suit arising from seizure of Panamanian boat in Algerian waters by Algerian authorities not within FSIA jurisdictional grant since the dispute had no contacts to the U.S. and raised no issues of U.S. law), *reh'g denied*, 734 F.2d 1479 (1984).

<sup>144</sup> *See Callejo v. Bancomer, S.A.*, 764 F.2d 1101, 1116 (5th Cir. 1985); *accord West v. Multibanco Comermerex, S.A.*, 807 F.2d 820, 828 (9th Cir.), *cert. denied*, 482 U.S. 906 (1987).

<sup>145</sup> *See Callejo*, 764 F.2d at 1120 (court defers to currency regulations promulgated by Mexico in order to foster Mexican compliance with the International Monetary Fund [hereinafter IMF] stabilization agreement).

<sup>146</sup> HOUSE REPORT, *supra* note 11, at 6615.

ample, a sovereign contracts to buy boots for the military, it is considered a commercial act even though the act occurs in a public defense context.<sup>147</sup> The key act in this analysis seems to be the making of a contract, an act not strictly limited to sovereigns.<sup>148</sup>

In cases subsequent to *Texas Trading* the contractual relationships between sovereigns and litigants have usually provided the basis for U.S. courts' exercise of jurisdiction under the commercial acts exception. For example, in *McDonnell Douglas Corp. v. Islamic Republic of Iran*,<sup>149</sup> the Eighth Circuit permitted jurisdiction over a defense contractor's suit against Iran. After Iran's 1979 revolution, McDonnell Douglas sued the revolutionary government for suspending payments on a 1975 contract for the purchase of fighter planes.<sup>150</sup> The circuit court held that the FSIA commercial acts exception allowed trial of the dispute in the U.S. since it arose out of a contract. That holding, however, ignored the fact that the purchase of warplanes is essentially reserved to sovereigns.

The failure of the Eighth Circuit to distinguish a contract for heavy munitions from other contracts can be understood as use of the commercial acts exception to protect a U.S. litigant by giving it access to U.S. courts. The facts of the case indicate that McDonnell Douglas could not otherwise have received a fair trial. While McDonnell Douglas sought compensation for having delivered the planes in accordance with the contract, Iran claimed it suspended payment because McDonnell Douglas ceased delivery of spare parts after the 1979 boycott imposed by the U.S. State Department.<sup>151</sup> The court upheld federal court jurisdiction because it did not trust the Iranian courts to respect the constraint put on McDonnell Douglas by the State Department boycott.<sup>152</sup> The Eighth Circuit doubted that any of the merits would be fairly considered in Iranian courts. Both the circuit court and the district court accorded a great deal of weight to an affidavit regarding legal conditions in Iran filed by Lewis Johnson, an American who prior to 1979 had practiced law in Teheran. Johnson stated that "no such U.S. national can under present conditions expect to receive a fair, impartial and just hear-

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<sup>147</sup> See *Texas Trading Corp.*, 647 F.2d at 309 (dicta); see also *Hearings on H.R. 3493 before Subcommittee on Claims and Governmental Relations of the House Committee on the Judiciary*, 93rd Cong., 1st Sess. 16 (1973) (testimony of Charles N. Brower, Legal Advisor, Dep't of State).

<sup>148</sup> See *Texas Trading Corp.*, 647 F.2d at 309.

<sup>149</sup> 758 F.2d 341, *aff'g* 591 F. Supp. 293.

<sup>150</sup> See 758 F.2d at 343-44.

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* at 346.

ing of any such case before an Iranian court.”<sup>153</sup> The Eighth Circuit ruling thus seems predicated on the hostile state of affairs between the U.S. and Iran and the inability of the plaintiff to receive a fair trial.<sup>154</sup>

Other courts have likewise held that the commercial acts exception encompasses contracts made in a sovereign capacity where public policy favors access to U.S. courts. The U.S. Court of Appeals for the District of Columbia (D.C. Circuit) upheld a grant of federal court jurisdiction in *Practical Concepts, Inc. v. Republic of Bolivia*.<sup>155</sup> The court determined that the commercial acts exception applied to a dispute in which Bolivia stopped payment on a rural development consulting contract after suspension of Agency for International Development (AID) funding.<sup>156</sup> It seems clear that publicly funded development of rural areas can be regarded as a sovereign act. Moreover, AID funding is generally available only to state-run projects. The D.C. Circuit, however, seems to have been swayed by the position advanced in an amicus brief filed by the U.S., which claimed the funding was simply public financing of a commercial undertaking, and therefore not a sovereign act.<sup>157</sup> Such a holding encourages U.S. businesses to enter into AID-funded contracts, since disputes arising under them will be afforded hearing in U.S. courts.

Beyond mischaracterizing essentially sovereign contractual relations as commercial acts, at least one court invoked the commercial acts exception where the commercial act alleged for jurisdictional purposes was of small import to the matter in dispute. In *Proyecfin de Venezuela, S.A. v. Banco Industrial de Venezuela*,<sup>158</sup> the alien debtor,

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<sup>153</sup> 591 F. Supp. at 303.

<sup>154</sup> Inability to receive a fair trial is not always determinative in questions of jurisdiction under the FSIA. In *Amerada Hess*, 109 S. Ct. 683, the U.S. Supreme Court recently refused to allow jurisdiction of a dispute in which a Liberian flag tanker returning from delivery of oil to the U.S. was bombed by Argentina during the Falklands War. The Court rejected the claim that jurisdiction existed under the Alien Tort Statute, since the FSIA was held to have superseded all other statutory grants of jurisdiction over foreign sovereigns. *Id.* at 688. The suit was further held to fall under none of the stated exceptions of the FSIA. *Id.* at 690–92. Thus, in spite of the fact that the courts of Argentina refused to hear the claim, the Court would not grant jurisdiction. The legal bases for the *Amerada Hess* holding are probably the availability to the plaintiff of the Liberian courts and the lack of effect on U.S. commerce. What is interesting is that the U.S. filed an amicus brief on behalf of Argentina, suggesting a desire to protect the fragile new regime in Buenos Aires. *See id.* at 626 (listing appearances in the case). One suspects that the Tate letter regime is not entirely dead.

<sup>155</sup> 811 F.2d 1543 (D.C. Cir. 1987).

<sup>156</sup> *Id.* at 1545.

<sup>157</sup> *Id.* at 1551.

<sup>158</sup> 720 F.2d 390.

Proyecfin, had sued the state-run Venezuelan bank in a dispute over the terms of a loan agreement.<sup>159</sup> In the loan agreement the defendant bank had waived immunity to suit in the U.S. in any dispute arising from the agreement.<sup>160</sup> The waiver removed any objection the bank might raise with regard to the existence of U.S. subject matter jurisdiction.<sup>161</sup> The Second Circuit further found that release of the loaned funds by the bank's New York branch was a sufficient contact to the U.S. to support exercise of personal jurisdiction over the suit. The issuance of a check in New York is hardly germane to resolving a dispute over the terms of a contract negotiated in Venezuela.<sup>162</sup> This ruling, however, supports the desire of the banking bar to increase the attractiveness of New York as a financial center by easing access to its courts.<sup>163</sup>

The commercial acts exception also served as a jurisdictional basis for suit against a sovereign entity in a suit unrelated to that sovereign's commercial activities. In *State Bank of India v. National Labor Relations Board*,<sup>164</sup> a three judge panel of the Seventh Circuit determined that the state-run Bank of India was not entitled to sovereign immunity under the FSIA, giving the NLRB jurisdiction over a labor dispute between the bank and its employees.<sup>165</sup> Although the dispute arose in a context not anticipated by the FSIA,<sup>166</sup> the court determined that the FSIA supported NLRB jurisdiction because the bank's activities in the U.S. were commercial in nature.<sup>167</sup> In effect, the Seventh Circuit held that a sovereign's commercial acts in the U.S. expose it to NLRB jurisdiction of its labor disputes. However attenuated this application of the commercial acts exception seems, it supports the policy of encouraging compliance with U.S. labor laws.

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<sup>159</sup> See *id.* at 394.

<sup>160</sup> *Id.* at 393.

<sup>161</sup> *Id.* at 395.

<sup>162</sup> Compare *id.* at 396 (payment in New York by Venezuelan bank to Venezuelan party under contract made pursuant to laws of Venezuela sufficient to support exercise of personal jurisdiction) with *Texas Trading Corp.*, 647 F.2d at 312, 314-15 (payment in New York by U.S. bank to U.S. citizen corporation under contract made pursuant to laws of U.S. sufficient to allow exercise of personal jurisdiction).

<sup>163</sup> See Feldman, *Amending the Foreign Sovereign Immunities Act: The ABA Position*, 20 INT'L LAW 1289, 1290 (1985) (discussing the desire of the banking bar that borrowing be considered a commercial act under the commercial acts exception of the FSIA, thus insuring access of U.S. creditors to U.S. courts).

<sup>164</sup> 808 F.2d 526 (7th Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987).

<sup>165</sup> 808 F.2d at 535.

<sup>166</sup> See generally 28 U.S.C. § 1605 (no mention of exception to sovereign immunity for labor disputes or with respect to administrative procedures).

<sup>167</sup> 808 F.2d at 535.

B. *Examples of Judicial Restraint in the Application of the FSIA to Sovereign Acts*

The refusal of some courts to hear certain cases against foreign sovereigns indicates that U.S. courts do not always abuse the power they have been granted under the FSIA. A good example of judicial restraint is the dismissal of U.S. suits arising out of Mexico's foreign exchange crisis in 1982. In response to pressures from the International Monetary Fund (IMF) and foreign lenders, Mexico nationalized its banks and forbade the export of dollars from the country.<sup>168</sup> Investors' dollar accounts in Mexican banks were converted into pesos at a rate of 70 pesos to the dollar, about 40 pesos less than the market exchange rate.<sup>169</sup> American investors who suffered losses as a result of these actions sued the Mexican banks in U.S. courts,<sup>170</sup> claiming that the FSIA commercial acts exception allowed the exercise of federal court jurisdiction.<sup>171</sup>

The question of whether U.S. courts could exercise jurisdiction over these suits was complicated by the role of the Mexican government in the conflict. As a consequence of Mexico's non-commercial actions in the affair, the Fifth Circuit in *Callejo v. Bancomer, S.A.*<sup>172</sup> was forced to rule on the applicability of the act of state doctrine. The act of state doctrine stands for the proposition that certain paradigmatically sovereign acts of foreign states will not be examined by U.S. courts in suits over which they otherwise have valid jurisdiction.<sup>173</sup> As the Supreme Court noted in *Ricaud v. American Metal Co.*,<sup>174</sup> the act of state doctrine "does not deprive [U.S.] courts of jurisdiction once acquired over a case. It requires only that . . . [certain sovereign actions] be accepted as a rule for their decision."<sup>175</sup> Thus the act of state doctrine, unlike the doctrine of sovereign immunity, is not a jurisdictional rule. It is instead a mechanism whereby consideration of certain questions will be foreclosed in cases involving state action.<sup>176</sup> Which state actions trigger the

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<sup>168</sup> See *Callejo*, 764 F.2d at 1106.

<sup>169</sup> *West*, 807 F.2d at 823. Some investors suffered a net loss of one third of their investment.

<sup>170</sup> See, e.g., *Callejo*, 764 F.2d 1101; *Wolf v. Banco Nacional de Mexico, S.A. (Banamex)*, 739 F.2d 1458 (9th Cir. 1984), *cert. denied*, 469 U.S. 1108 (1985); *West*, 807 F.2d 820.

<sup>171</sup> See *Callejo*, 764 F.2d at 1106.

<sup>172</sup> *Id.* at 1101.

<sup>173</sup> See *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 416 (1964).

<sup>174</sup> 246 U.S. 304 (1918).

<sup>175</sup> *Id.* at 309.

<sup>176</sup> In the archetypal act of state suit, the plaintiff has had property expropriated by a



doctrine is a matter of some dispute.<sup>177</sup> At best, it seems fairly certain that any act which would be immune under the FSIA would likely fall under the act of state doctrine.<sup>178</sup>

The disposition of *Callejo* therefore hinged on whether the court considered the sovereign acts or commercial acts most germane to the dispute. On the one hand, promulgation of the currency regulations by the government was clearly a sovereign act, consideration of which would be barred by the act of state doctrine. On the other hand, the failure of the banks to honor the investment agreements was clearly a commercial act, which would allow exercise of U.S. court jurisdiction under the FSIA.<sup>179</sup> Considering both aspects, the Fifth Circuit first held that the dispute in *Callejo* arose from the banks' failure to honor the investment contracts and upheld U.S. jurisdiction of the suits under the FSIA commercial acts exception.<sup>180</sup> The court also noted, however, that the actions of the Mexican banks were the result of government regulations.<sup>181</sup> Applying the act of state doctrine, the court decided it was not competent to assess the validity of the Mexican currency regulations, and held that the banks had simply acted in accordance with government regulations. The act of state doctrine precluded further consideration of the dispute and the case was dismissed.<sup>182</sup> The court also noted that deference to the IMF plan to restructure Mexico's troubled finances required dismissal of the case.<sup>183</sup> Other courts adopted reasoning similar to that of *Callejo* to dismiss other Mexican bank cases.<sup>184</sup>

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foreign sovereign who then transfers the property to a third party. The plaintiff then sues the third party for replevin of the property. The non-sovereign defendant would not be entitled to jurisdictional immunity. The act of state doctrine, however, would preclude questioning the validity of the state's action in expropriating the property. *Sabbatino*, 376 U.S. at 435. While in this example the act of state doctrine would dispose of the plaintiff's claim in its entirety, it is conceivable that the act of state doctrine will not always require dismissal of claims to which it applies.

<sup>177</sup> See Note, *The Marcos Cases: A Consideration of the Act of State Doctrine and the Pursuit of Assets of Deposed Dictators*, 9 B.C. THIRD WORLD L.J. 81, 91 (1989) (two views of what constitutes an act of state: 1) any act by a government official; or 2) acts reserved to sovereign entities).

<sup>178</sup> See *Alfred Dunhill of London v. Republic of Cuba*, 425 U.S. 682, 695 (1976) (public acts of sovereign protected by act of state doctrine while commercial acts are not).

<sup>179</sup> *Callejo*, 764 F.2d at 1108.

<sup>180</sup> *Id.* at 1112.

<sup>181</sup> See *id.* at 1108.

<sup>182</sup> See *id.* at 1115-16; *West*, 807 F.2d at 828.

<sup>183</sup> See *Callejo*, 764 F.2d at 1120 (acquiescence to IMF agreement); *West*, 807 F.2d at 832 (IMF agreement dictated Mexican actions and court will not overturn them). In addition, the court in *West* suggested that the prudent investor knew or should have known that substantial fluctuations can occur in Third World investments. See *id.* at 831.

<sup>184</sup> See, e.g., *West*, 807 F.2d at 828.

The Mexican bank cases suggest that the commercial acts exception may not provide the best test of whether a sovereign act will be assessed in U.S. courts. More importantly, these cases show that the courts recognized the burden such suits would put on Mexico's troubled finances, leading the courts to protect the banks. In this respect, the courts' actions are quite similar to the original Tate letter regime.<sup>185</sup>

In sum, the line of cases following *Verlinden* has permitted exercise of federal court jurisdiction where important American interests are involved. If a litigant can demonstrate both commercial contact by a sovereign with the U.S. and important interests at stake, personal jurisdiction can be exercised over the suit. As the disposition of some cases suggests,<sup>186</sup> U.S. courts can be fair in ruling on the merits of a given case. This does not, however, mitigate the difficulties incurred by developing country defendants forced to litigate in an inconvenient forum with few contacts to the litigation. Finally, implicit in the grant of jurisdiction to protect U.S. interests is the reluctance or refusal of courts to apply any law other than U.S. law.<sup>187</sup> The net effect is to hinder the acceptance of the development agenda into international law.

#### V. CONCLUSION: SOME SUGGESTIONS

The doctrine of restrictive sovereign immunity has perpetuated resort to Western courts for resolution of private disputes with foreign sovereigns. The doctrine has impeded developing countries' efforts to control the resolution of their international disputes. It has also hindered acceptance of the development agenda into international law by channelling litigation to courts which reject the agenda's claims. In order to render a more equitable dispute resolution system, both the Western countries and the developing countries will have to retreat from their current stance on jurisdiction of sovereign disputes.

The developing countries do not agree with the Western countries on how quickly international law should change and accept

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<sup>185</sup> See *supra* notes 77-82 and accompanying text.

<sup>186</sup> See *National American Corp.*, 448 F. Supp. at 646 (judgment on the merits in favor of Nigeria in a cement crisis dispute on grounds that plaintiff had executed a valid discharge of prior agreement).

<sup>187</sup> See generally, R. MEAGHER, *supra* note 7; R. ANAND, *supra* note 17 (noting the failure of Western nations to accept principles of international law advocated by the developing countries).

new concepts. The Third World argues in the Charter and the NIEO for rapid change. While developing countries have rapidly gained political independence, true economic independence has come at a snail's pace. The development agenda attempts to accelerate economic development through the agency of international law. The agenda would allow developing countries to resolve disputes with foreign investors under their own rules, thus rendering resolutions most favorable to the developing countries. The developing countries see this deliberate favorable treatment as a means of reversing the inequity of the old economic order and as a key to achievement of economic parity with the Western countries.

The Western nations, by contrast, oppose the rapid change in international law embodied in the development agenda. The Western countries have a vested interest in perpetuation of the existing legal order. The favorable position of Western investors in the Third World was obtained under color of traditional international law. Western holdings in the Third World are protected only by the good graces of the sovereign and the right to seek damages for expropriation in Western courts. The Western countries have little to gain and much to lose by accepting the legal claims of the development agenda. The expansion of U.S. court jurisdiction after *Verlinden* demonstrates the extent to which Western courts are willing to exercise protective jurisdiction on behalf of Western foreign investments. Western courts remain a safe harbor for Western investment.

The root of the competing claims to adjudication of international disputes is a desire to protect domestic interests. For developing countries, domestic litigation of disputes is a means of furthering rights asserted under the NIEO and the Charter. For Western countries, expansion of jurisdiction under restrictive sovereign immunity gives their citizens greater redress when they are injured by the acts of foreign sovereigns. Were the international community truly one of equals, these interests could be balanced, much as the competing jurisdictional claims of the states and the federal government are balanced in the American legal system. Unfortunately, persistent inequities in the world power structure prevent protection of the aims of developing countries.

In order to promote the development agenda two steps are necessary. First, the aims of the development agenda must be accepted by the entire international community. Second, disputes with developing country sovereigns must be heard before truly neutral tribunals. These steps are possible only if the development agenda

is put forward on less aggressive terms which accommodate the valid concerns of Western countries regarding their citizens' interests abroad.

Acceptance of the development agenda by the Western countries is forestalled by the developing countries' insistence that they may both expropriate property and unilaterally set the compensation for the taking. Reasonable resolution of such issues would be possible before impartial tribunals rather than before the courts of the investor's nation or of the sovereign. Abandonment of the asserted unilateral right of adjudication in favor of impartial resolution would promote acceptance of the remainder of the agenda. Unfortunately, the Third World seems reluctant to soften its stance. Some developing countries, especially in Latin America, have demonstrated a concerted opposition to attempts to encourage international resolution of investment disputes.<sup>188</sup> These countries may find, however, that continued assertion of the unilateral right of adjudication frightens away vitally needed Western capital.<sup>189</sup> If developing countries would willingly resort to international arbitration, they could structure its terms to be more sympathetic to the claims of the development agenda.

Investment agreements between developing countries and Western investors could require submission of disputes to international arbitration, thus keeping those disputes out of Western courts. In the *Topco/Calasiatic* arbitration the arbitrator acknowledged the right of developing countries to expropriate property held by foreigners. The arbitrator's statement, while only dicta, holds open the hope that such tribunals would be more sympathetic to certain concepts of the Charter than would traditional courts.<sup>190</sup> In this fashion, developing countries can insure access to a forum which is equally convenient to both host country and investor, is relatively impartial and is potentially more receptive to the concepts of the development agenda. A move in this direction by developing countries will bring them much closer to their stated goal of a new international economic order.

Kevin M. McGinty

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<sup>188</sup> See *Debt Equity Swaps*, *supra* note 7, at 48.

<sup>189</sup> *Id.* at 40.

<sup>190</sup> See *Topco/Calasiatic Arbitration*, 17 INT'L LEGAL MATERIALS at 21.